



3rd Quarter 2019

President Trump's infamous tweets on trade continue to spark serious disputes between the world's most influential superpowers as a fickle Federal Reserve (Fed), rising recessionary fears, and the upcoming U.S. presidential election top the list of potential domestic risks. Mix in a global economic slowdown, Brexit uncertainty, Italy's budget crisis, escalating tensions with Iran, the long-running political crisis in Venezuela, and you have the perfect recipe for a volatile market. While most of these headlines serve as daily noise to give investors both sugar highs (and sugar crashes), investors must be prudent with their investments and remain committed to their long-term financial plans.

U.S. Economy

With the U.S. economy poised to notch the longest economic expansion in the history of our country in July (121 months), investors can no longer count on tax cuts, quantitative easing, or early-cycle "bounce back" growth to support the market. While risks have risen, the expectation is that the U.S. economy will not slip into recession over the next 12 months.

Trade Wars

U.S./China trade tensions have been a hallmark of President Trump's time in office and a major market overhang that threatens to initiate a decoupling of the world's largest economies, disrupting supply chains, and potentially hitting company earnings in the process.

Trade angst that leads to less interaction between economies, in most circumstances, leads to lower economic growth as supply chains are interrupted and more alternatives are less cost-efficient. China may no longer be the cheapest country to manufacture many goods, but a sharp slowdown in the country's exports due to trade-war angst threatens much more than just a reduction in the country's economic growth level. More trade frictions create further pressures and incentives for Europe to choose a side, or face new tariffs or sanctions from others.

The Economics of Tariffs

Tariffs raise costs, disrupt supply chains, invite retaliation in the form of increased tariffs against U.S. exports, and dampen business fixed investment. There is growing evidence that tariffs are having a negative impact on U.S. economic growth but, to date, they appear unlikely, by themselves, to push the U.S. economy into a recession. The potential third round of tariffs would have a greater impact. Some Fed officials may fear the inflationary implications of tariffs. However, that impact would be transitory. The bigger concern should be the drag on growth. Hence, the Fed could lower short-term interest rates by the end of the year. Such an outcome is already anticipated in the federal funds futures market, which is pricing in a 100% chance of one or more rate cuts by the end of this year.

Economic Snapshot

The near-term outlook has been mixed, with a healthy consumer sector, but softness in business fixed investment. With the May 10 increase in tariffs on Chinese goods, the drag on U.S. growth has become more noticeable and a further escalation (25% tariffs on the remaining \$300 billion or so in Chinese goods) would likely have an impact on the economy. The Federal Reserve (Fed) is poised to lower short-term interest rates, if needed. Risks to the growth outlook are weighted to the downside, but much depends on whether we'll see a resolution of trade tensions.

FAVORABLE	EMPLOYMENT	Job markets remain tight. Monthly changes in nonfarm payrolls are volatile, but the underlying trend in job growth has moderated in recent months, partly reflecting labor force constraints.
	CONSUMER SPENDING	Job gains, wage growth, and consumer confidence remain supportive. Second quarter spending figures appear stronger, but that's not much of a stretch following a weak first quarter.
	HOUSING AND CONSTRUCTION	Continued strength in the labor market and this year's sharp drop in mortgage rates should support housing activity in the near term. Higher building costs and affordability remain key issues.
NEUTRAL	GROWTH	Economic activity has been mixed, but generally slower, with an increased drag from tariffs. Risks to the growth outlook are weighted to the downside, but depend on a resolution of trade tensions.
	BUSINESS INVESTMENT	Slower global growth and trade policy uncertainty are negative factors. Orders and shipments of capital equipment remain on a soft track in recent months.
	MANUFACTURING	Slower global growth has dampened export growth, while trade policy has disrupted supply chains and raised production costs. Factory output has contracted, but that doesn't mean a recession in the overall economy.
	INFLATION	Inflation can be too low as well as too high and the sub-2% trend in the PCE Price Index is a significant concern for the Fed. Despite tariffs, pipeline pressures have moderated. Firms have had mixed success in raising prices.
	MONETARY POLICY	The Fed is poised to lower short-term interest rates, if needed, and the proximity to the zero-lower-bound means that officials should be more aggressive in lowering short-term interest rates than they would otherwise.
LONG-TERM INTEREST RATES	LONG-TERM INTEREST RATES	Long-term interest rates have fallen outside of the U.S., putting downward pressure on U.S. bond yields. Inflation is expected to remain low and the risks to growth are weighted to the downside.
	FISCAL POLICY	The impact of tax cuts has faded in 2019. The federal budget deficit has increased, but not put much upward pressure on bond yields. State and local government fiscal policy is pro-cyclical, a negative force in a recession.
	THE DOLLAR	In the short term, exchange rates are driven by monetary policy. Market expectations of a Fed ease are negative for the greenback, but monetary policy is also seen as easing elsewhere.
REST OF THE WORLD	REST OF THE WORLD	The global economic outlook has deteriorated further, with increased concerns regarding China, Europe, and the UK. Trade tensions between the U.S. and China aren't helping.

Raymond James. "Economic Snapshot." *Investment Strategy Quarterly*. Pg. 5,7,8, Web.

Raymond James, "Investment Strategy Quarterly Recap." *Investment Strategy Quarterly*. Pg. 16, Web.

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